S&P Global
Ratings

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Summary:

Cincinnati; Water/Sewer

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Summary:

Cincinnati; Water/Sewer

Credit Profile		
US$103.52 mil wtr sys rfdg rev bnds ser 2016B due 12/01/2030		
Long Term Rating	AAA/Stable	New
US$25.0 mil wtr sys rev bnds ser 2016A due 12/01/2046		
Long Term Rating	AAA/Stable	New
Cincinnati wtr (RMKTD) (MBIA)		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AAA' long-term rating to Cincinnati, Ohio's series 2016A water system revenue bonds and series 2016B water system refunding revenue bonds. We have also affirmed our 'AAA' rating on the city's outstanding water system bonds and removed our rating on its series 2005B water revenue bonds because the bonds have been defeased. The rating reflects, in our opinion, the combination of a very strong enterprise risk profile and an extremely strong financial risk profile. The outlook is stable.

The enterprise risk profile reflects our view of the system's:

- Service area participation in the broad and diverse Cincinnati metropolitan statistical area (MSA) economy;
- Very low industry risk as a monopolistic service provider of an essential public utility;
- Generally affordable rates as benchmarked against Hamilton County's median household effective buying income (MHHEBI) and its poverty rate; and
- Strong operational management practices and policies, in our view.

The financial risk profile reflects our view of the system's:

- Financial performance that has exceeded by wide margins both bond covenant and internal policy minimums;
- Strong financial management practices and policies, in our view.

Additionally, the rating reflects the regional nature of the service base, which extends beyond Hamilton County and northern Kentucky, although not into the entire MSA. The city has also represented that it is actively seeking additional wholesale customers.

Cincinnati's water system has a predominantly locally derived revenue base. Local service charges, derived through an autonomous rate-setting process, represent virtually all of the system's revenues. This, coupled with operating expense flexibility, limits exposure to federal revenues.

Bond proceeds will be used to both refund existing bonds and finance capital improvements.

A pledge of net revenues of the system secures the senior-lien bonds. Bond provisions associated with the city's senior-and subordinate-lien revenue bonds require:

- Water rates that will generate revenue sufficient to cover senior debt service by 1.15x and total debt service by 1.0x;
- The ability to issue additional bonds only if historical net revenues produce coverage of 1.15x maximum annual debt service (MADS) on senior debt service and 1.0x on total debt service; and
- A bond reserve for senior bonds that has been funded at the lesser of MADS, 125% average annual debt service, or 10% of par.

Cincinnati's water system service area spans parts of both southwestern Ohio and northern Kentucky. The largest city in the service area is Cincinnati with a population of slightly less than 300,000. The section of the water system in Ohio includes most of Hamilton County and parts of Butler, Warren, and Clermont counties. The water system serves about 240,000 accounts; more than 1 million customers; and about 20 surrounding municipalities through retail, wholesale, standby, or a combination of these service agreements. The system's two treatment plants have a combined 280 million gallon per day (mgd) treatment capacity, which was adequate for its 117 mgd and 160 mgd average and peak use, respectively, during 2016. Draws from the system's two sources, the Ohio River and an aquifer, have no quantity limits.

Officials have identified and planned $600 million of system improvements from 2017 to 2023. Management will cover about 80% with planned borrowing, but has indicated its intent to actively work toward a greater 35% cash contribution to capital spending. Over the current planning horizon, management has indicated that the cash contribution could be over 50%.

Enterprise and financial risk profiles

The region's economic base is anchored by the broad and diverse economic base of Cincinnati, which is supportive of the rating, in our opinion. Large employers in the Cincinnati MSA include The Kroger Co. (headquarters, 21,646 employees), the University of Cincinnati (16,016), and The Proctor & Gamble Co. (headquarters, 11,000). With a population greater than 800,000, Hamilton County serves as the population center for the region. MHHEBI for the county is 90% of the national average, but Cincinnati's income levels are significantly lower, with MHHEBI at 65% of the national average. We use the county's MHHEBI for our economic and rate affordability benchmarking since most of the customer and revenue base are in the county.

Since 2003, the city has increased water rates annually (excluding 2011). Each rate increase has generally been between 3% and 9%. A monthly-equivalent (since residents are billed quarterly) residential water bill for Cincinnati residents that use 800 cubic feet per month is $26.01, which includes a monthly-equivalent service charge, commodity charges for 800 cubic feet, and a hydrant charge. As mentioned above, we benchmark this against Hamilton County's MHHEBI and the 18% poverty rate. Our methodology measures affordability for not only the median household, but also takes into account sensitivity to rate affordability based on the county poverty rate. Our view of the market position is somewhat more negative compared to a situation where a utility has both low nominal rates and a lower poverty rate.

Since fiscal 2011, the water system has posted greater than 1.5x total debt service coverage (DSC) and 300 days' current cash and investments. DSC levels are calculated using net revenues (excluding depreciation), adding into net revenues interest earnings and noncash expenses related to pension and other postemployment benefit (OPEB) payments (as reported in the city's audit). Net revenues provided 1.5x total DSC at fiscal year-end (June 30) 2015. For 2016, management expects to post net revenues that generate about 1.7x total DSC.

Financial projections through fiscal 2021 take into account annual approved 3.75% rate increases, as well as inflationary cost increases for operations and maintenance (O&M) expenses. Management's projections indicate minimum total DSC of 1.5x and continued maintenance of unrestricted cash representing at least 450 days of O&M expenses. We expect the city will be able to exceed its projections and generate a higher level of DSC more in line with higher historical trends as it has been able to do in the past. We note that the projected 1.5x total DSC is a low point, and the city projects that total DSC will rise to about 1.8x in 2021.

Debt to plant at fiscal year-end 2015 was about 50%, which has generally remained at this level over time since debt is rolled off as capital construction is completed. Given management's ongoing cash contributions for capital projects and because there is no large treatment facility or environmental compliance project in the capital plan, we do not expect the system's leverage to deteriorate or significantly differ from these historical trends.

Supporting the system's financial operations are a wide array of management policies. The system has two reserve funds to support the capital program and provide general working capital. Its 20-year master plan flows into a more detailed six-year capital plan that identifies specific projects and funding sources. A three-year strategic business plan focuses on management's goals for additional service delivery (billing, environmental, and engineering services) to existing customers, as well as growth in the customer base. Management has also indicated that it retains backup power generators for a full three-day blackout scenario and three days' potable water storage.

Outlook

The stable outlook reflects our expectation that the system will continue to generate financial results that routinely exceed projections within the two-year outlook period. This will be a key factor in maintaining the current rating since the projected low point of 1.5x total DSC is, in our view, not consistent with the current rating level.

However, other strong factors support the rating at its current level, including the maintenance of strong liquidity that can be used to absorb any unexpected revenue declines or expenses, management's intent to continue with annual rate increases, and the overall diversity of the system's service base.

Downside scenario

We would likely either lower the rating or change the outlook to negative if total DSC does not continue to outperform projections, even if other relevant credit factors do not necessarily deteriorate.

Ratings Detail (As Of November 4, 2016)		
Cincinnati wtr bnds		
Long Term Rating	AAA/Stable	Affirmed
Cincinnati wtr subord (RMKTD)		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.